No. 11,937

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

JOHN O. ENGLAND, Trustee of the Estate of Burlingame Products Co., Inc., Bankrupt,

Appellant,

vs.

F. W. MACKAY,

Appellee.

BRIEF FOR APPELLEE.

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FERNAU WALSH PRINTING CO., SAN FRANCISCO

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APPELLANT'S STATEMENT OF THE CASE IS CONTROVERTED:

Controverted, that is to say, as to any assumption that it consecutively, fully or fairly presents the facts brought out in the testimony before the referee (Tr. pp. 35-97). As what we claim to be an impartial summary of the same, we herewith reproduce substantially the affidavit of Appellee MacKay on order to show cause (Tr. pp. 10-14), in the form taken by the same in his statement of facts on petition for review before the District Court:

Petitioner F. W. MacKay is an American citizen, of the age of 53 years or thereabouts, and by profes-

sion a geologist and mining operator. Approximately sixteen years ago he retired from professional and general business activities and since that time has devoted himself to travel and the pursuit of outdoor recreation.

Petitioner has no dependents nor any living near relatives. He has from sources outside the State of California an income sufficient to supply his wants and he has no motive nor incentive, nor any desire nor inclination to amass properties, to increase his income, nor to re-enter business activities of any kind, but from time to time he has become acquainted with worthy individuals who were struggling to advance themselves under difficulties and has advanced them financial aid but with no motive of profit to himself except to recover the amount of such advances and possibly interest thereon at current commercial rates.

During the war period petitioner became acquainted in San Francisco with one Joseph O. Mauborgne, Jr., through a common interest in breeds of dogs, and formed for him liking and regard; said Mauborgne is in the business of running a pet shop and had knowledge of a small bird-cage manufacturing business operated by an individual who wanted to retire, and he, Mauborgne, wished to acquire and operate the same as a side line to his store, more especially as there was a war shortage of the product, and to him petitioner advanced the money required to purchase the machinery and equipment used in said business. Said transaction was made under an agreement between petitioner and said Mauborgne that the latter

should devote all necessary time in mechanical and managerial services to the operation of the said business, without salary or compensation other than that the profits thereof would be divided share and share alike between himself and petitioner. Said purchase was made, and Mauborgne took over the equipment and operation of the said business accordingly, and continued the same in the said City of San Francisco under the trade name of Western Products Company. Bird-cages were and are important to said Mauborgne but of no interest or consequence to petitioner.

During the early part of the year 1946 petitioner decided to return for an indefinite period to the Island of Tahiti in the South Pacific, where he had resided and had interests previously to his coming by reason of the war to San Francisco, and he thereupon consulted an attorney with respect to his local business affairs, and was by the latter advised that the business last referred to did not have proper legal standing inasmuch as the fictitious name thereof had never been registered as required by law.

Upon consultation between petitioner and said Mauborgne it was mutually agreed that they would form a corporation to take over and operate the said business, on the basis that the profits and emoluments thereof of whatever the same might consist would be divided share and share alike between the two, and in pursuance of said agreement a corporation was formed, under the name Burlingame Products Company, which took over the assets and operation of the preceding business, and inasmuch as its facilities in

San Francisco were inadequate—there had also been a fire in the San Francisco premises and condemnation by the Fire Department—moved the same to the City of Burlingame, County of San Mateo, California, in the course of which petitioner made further cash advances to the said corporation, of which Mauborgne had become president and manager and who thereafter gave to it his full time and services and the use of his automobile without salary or compensation other than his agreed prospective one-half share in the profits and any issue of corporate stock which might result. The said Mauborgne also from time to time made contributions in cash for the benefit of said corporation, the amount of which petitioner does not at present recollect.

Petitioner did not become a director or officer of the said corporation, and shortly after its formation departed for the Island of Tahiti, where he remained until in or about the month of September, 1946, when he returned to San Francisco and found that the said corporation was in a state of insolvency. In this period there were no communications actual or possible between him and the corporation or its officers.

At the first meeting of the board of directors of said corporation its attorney was requested and instructed to make application to the Corporation Commissioner of the State of California for the issuance of corporate stock, in such amounts as in his opinion were justified by the financial condition of the company; petitioner is informed by said attorney and believes and therefore alleges that in the interim last mentioned no ap-

plication was filed with the said Corporation Commissioner for the issuance of stock for the reason that the removal of the corporate business from San Francisco and its re-establishment in Burlingame involved numerous complications and distractions on the part of the company's officers and that the financial and other statements required by law and regulations for a proper application to the Commissioner could not be obtained.

In addition to the instance hereinabove cited, on three other occasions this petitioner has made financial advances to individuals whom he considered personally worthy, in order that they might individually better their condition in the community, on an agreed basis of sharing in profits and emoluments, two of which were in the ratio of equal shares and the other at a somewhat different percentage. (This modest business, by way of identification, is the MacNeil bookstore, on 7th Street across from the Postoffice Building.)

THE ISSUES SHOULD BE CONSIDERED IN REVERSE OF THE ORDER SET UP BY APPELLANTS.

First, naturally, comes the question of jurisdiction, which, if the decision of the learned District Judge is to be affirmed, disposes of the whole case.

Second, and subordinate, are the errors of the referee in his findings of fact and conclusions of law.

A REFEREE IN BANKRUPTCY IS TOTALLY WITHOUT JURISDICTION TO MAKE A "TURNOVER ORDER" OF ASSETS NOT BELONGING TO THE BANKRUPT, BUT PRIVATELY OWNED BY A THIRD PARTY.

No better exposition of the above theorem is to be found than that contained in the order of the learned District Judge herein setting aside the order of the referee (Tr. pp. 23-27).

This case is not one of first impression, and a text-book statement of the rule is:

> "A court of bankruptcy has power to order the bankrupt to pay or to deliver to the trustee money or other property found to be in his possession or control, constituting a part of his estate in bankruptcy, and which he has not surrendered or accounted for, and to enforce obedience to such order by commitment as for contempt. Two conditions are essential to the exercise of this power: (1) That the money or property in question should be a part of the bankrupt estate; and (2) that it should be in the possession or under the control of the bankrupt at the time when the order for its delivery is made."
>
> 7 *Corpus Juris,* par. 229, p. 137.

In support of the above pronouncement of principle:

> "Two essential facts condition the lawful exercise of the power to require a bankrupt or other person to pay or deliver to the trustee money or property in his possession. They are that the money or property directed to be delivered to the trustee is a part of the bankrupt estate, and that the bankrupt or person ordered to deliver it has it

in his possession or under his control at the time the order of delivery is made."

In re Rosser, 101 Fed. 562.

Quoting the decision by Sanborn, J., supra:

"It will be seen from the foregoing authority that not only must the money or property ordered to be turned over be a part of the bankrupt's estate, but it must also be established that it is in the possession or under the control of the bankrupt."

In re Adler, 170 Fed. 634, 636.

"A bankruptcy court has jurisdiction summarily to require bankrupt to pay over money or to surrender other property in his possession or under his control *belonging to the estate,* and upon his failure or refusal so to do to attach him for contempt, but a bankruptcy court may not enter a turn-over order against bankrupt unless property or money be found in bankrupt's possession." (Emphasis ours.)

In re Zappala, 44 Fed.Supp. 353.

Since the decision herein, the Supreme Court for the first time (Feb. 9, 1948) has taken occasion to discuss the origin, nature and scope of turnover orders, certiorari having issued to review an adjudication of contempt against an officer of a bankrupt corporation. Instead of quoting the opinion at great length, we believe a few paragraphs of syllabi will suffice:

"Bankruptcy,—jurisdiction to issue turnover orders.

1. The procedure by which a bankruptcy court requires by its order, disobedience of which is punishable as a contempt of court, property or records of a bankrupt to be turned over to the trustee in bankruptcy, is one not expressly created or regulated by the Bankruptcy Act, but is a judicial innovation by which the court, acting under its grant of jurisdiction to 'cause the estates of bankrupts to be collected' and 'of all controversies at law and in equity' between trustees and adverse claimants concerning property claimed by the trustee, and to 'make such orders, issues such process and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title', seeks efficiently and expeditiously to accomplish ends prescribed by the statute."

"Turnover order—basis and purpose.

6. An order requiring the turning over of property to a trustee in bankruptcy, disobedience of which is punishable as a contempt, is essentially one for restitution rather than indemnification. The primary condition of relief is possession of existing chattels or their proceeds capable of being surrendered by the person ordered to do so. It is in no sense based on a cause of action for damages or tortious conduct such as embezzlement, misappropriation or improvident dissipation of assets."

"Evidence—sufficiency to support turnover order in bankruptcy.

9. An order requiring the turning over of property to a trustee in bankruptcy must be supported by clear and convincing evidence, including proof that the property has been abstracted from the bankrupt's estate and is in the possession of the person proceeded against."

"Burden of proof in proceedings to obtain turnover order.

10. The burden is upon a trustee in bankruptcy seeking a turnover order to prove that the property in question has been abstracted from the bankrupt estate and is presently in the possession of the person proceeded against."

Maggio v. Zeitz as Trustee in Bankruptcy, 92 U.S. Advance Opinions, 376.

OBJECTION TO THE REFEREE'S JURISDICTION TO MAKE THE TURNOVER ORDER SOUGHT WAS MADE PROPERLY AND IN LIMINE.

The set-aside order of Brown, Dist. J., succinctly states the above as its basis (Tr. p. 24). The phraseology of the objection is assimilated from that of a general demurrer, as being that best suited to raise the issue of jurisdiction of the subject matter, with a prayer for discharge and dismissal forthwith of the order to show cause (Tr. p. 9). That this was urged, argued and specifically ruled upon *imprimis,* the following colloquy will show:

"The Referee. Really, what you are contending, Mr. McLeod, is that the corporation was the alter-ego of Mr. MacKay.

Mr. McLeod. That is true. That is what we are endeavoring to contend.

The Referee. Do you think your pleading is sufficient to show that? You have an allegation in the second paragraph to the effect that said F. W. MacKay and said corporation were and are, in reality, the same. That is an allegation of fact. I think the next sentence is really a conclusion of law. It is argumentative.

Mr. McLeod. That is a conclusion. I concede that. It is based upon the facts but that is a conclusion.

The Referee. Yes. I think the objection that the Petition for Order To Show Cause does not state facts or grounds sufficient to support any proceeding nor the relief therein prayed nor any relief whatsoever, should be overruled and such is the ruling." (Tr. pp. 95-96.)

We are far from conceding the referee's *obiter dictum* that any allegation of fact is embodied in the words "F. W. MacKay and said corporation were and are, in reality, the same". It is legally a fallacy and a nugacity—nothing more than a catch-phrase.

An order to show cause is not a pleading but merely a medium for summary service of a notice of motion.

42 *C. J.* 489.

The *riposte* to such an order is ordinarily designated as a *return,* involving only collateral issues. In this instance, that of jurisdiction being first and

foremost we chose the broader denomination of *response.*

Counsel's statement (Br. p. 13) that Appellee did not raise the question of jurisdiction prior to the entry of the referee's final order, we can characterize only as a fabrication in contravention of the record. According to the commentary of Healy, Circ. J., it was required of Appellee only that, before the referee, he "understandably protest the procedure". In abundance of precaution and in full measure, we "explicitly informed the referee".

cf. *Honeyman v. Hughes,* 156 Fed.2d 27, 29.

OF JURISDICTION—ITS DISTINCTIONS, AND OF THE MODES AND TIMELINESS OF INTERPOSING OBJECTIONS TO ITS EXERCISE.

The general field of jurisdiction is subject to numerous divisions and sub-classifications, such as general and limited, original and appellate, and many others. That with which we are here concerned is jurisdiction of the subject matter as differentiated from that of the person, and the legal incidents attaching, in that objection to latter can be waived by appearance, but the former cannot be conferred by appearance or any act of the parties.

Justice Miller's definition is:

> "By jurisdiction over the subject-matter is meant the nature of the cause of action and of the relief sought; and this is conferred by the sovereign authority which organizes the court, and it is to

be sought for in the general nature of its powers, or in authority specially conferred."

Cooper v. Reynolds, 10 Wall. 308, 316, 19 L.Ed. 931.

Quoting the above, an opinion in the Second Circuit adds:

"A general appearance cannot confer jurisdiction over the subject-matter of a suit for it is a fundamental principle of the law that consent of parties cannot give to a court jurisdiction of the subject-matter, and it consequently follows that a general or voluntary appearance does not give jurisdiction of the subject-matter." (citing authorities.)

U. S. v. New York, etc. S.S. Co., 216 Fed. 61, 67.

Want of jurisdiction of the subject matter may be taken advantage of at any stage of the proceedings.

Chicago First Nat. Bk. v. Chicago Title etc. Co., 198 U.S. 230, 49 L.Ed. 1051 (under the Bankruptcy Act);

15 *C. J.,* 847, citing columns of authorities.

Want of jurisdiction of the subject matter is ground for reversal on appeal or error.

Capron v. Van Noorden, 2 Cranch (U.S.) 126, 2 L. Ed. 229;

15 *C. J.,* 826, par. 144.

The objection may be raised for the first time on appeal.

15 *C. J.,* 849, and cited cases.

Appellee MacKay originally appeared before the referee on order of examination as a witness subpoenaed by the trustee (Tr. p. 65), a procedure within the referee's powers. Subsequently he was summoned anew under process, if it may be so called, of the order to show cause here under review, calling for the sequestration and surrender of all or any part of his private property. To any such jurisdiction he made prompt objection in writing (Tr. p. 9) and orally on the hearing (Tr. p. 88). This he ever since has and now strenuously maintains.

THE CORPORATE ENTITY OF THE BANKRUPT, BURLINGAME PRODUCTS COMPANY, CANNOT BE DISREGARDED AND APPELLEE MacKAY HELD LIABLE FOR ITS DEBTS.

This apparently was the object, vaguely conceived and insufficiently sought under the order to show cause served on Appellee. If there had been facts to justify such a judgment, and there were none, this end could have been attained only by a plenary suit in equity, and not by any summary order of a referee.

A CORPORATION, UPON ITS STATUTORY ORGANIZATION, BECOMES A LEGAL ENTITY, DISTINCT FROM ITS PROMOTERS OR SUBSEQUENT STOCKHOLDERS.

Recent federal decisions deal most frequently with the attempted imposition on stockholders of corporate income taxes, but the same principles apply without distinction to all corporate liabilities.

> "A corporation and its stockholders are generally to be treated as separate entities. Only under exceptional circumstances—not present here—can the difference be disregarded."
>
> *Burnet v. Clark,* 287 U.S. 410, 77 L.Ed. 397;
>
> *New Colonial Ice Co. v. Helvering,* 292 U.S. 435, 78 L.Ed. 1348, 1353.

Following the above decisions, the Circuit Court of Appeals, Fifth Circuit, holds:

> "It is lawful to obtain a corporate charter, even with a single substantial stockholder, to engage in a specified activity, and that activity may coexist with other private business activities of the stockholder. If the corporation is a substantial one, conducted lawfully and without fraud on others, its separate identity is to be respected. The tax laws of the United States recognize corporations; they tax them differently and sometimes discriminatorially. In tax matters it is only under exceptional circumstances that the separateness of the corporation from the stockholders can be disregarded, even when there is but one stockholder."
>
> *Ross v. Commissioner,* 129 Fed.2d 310, 313.

To illustrate the strict limitations on the equitable doctrine of disregarding the corporate entity, this does not apply even to cases where the incorporation was for the express purpose of avoiding future personal liability—and there is no evidence of any such purpose with respect to Burlingame Products:

"The organization of a corporation for the avowed purpose of avoiding personal responsibility does not in itself constitute fraud justifying the disregard of the corporate entity. In Elenkrieg v. Siebrecht, 238 N.Y. 254, 144 N.E. 519, 521, the court stated: 'Whether or not the corporation is the creature of Siebrecht is not a determining feature. Whether it be a subterfuge is misleading. Many a man incorporates his business or his property and is the dominant and controlling feature of the corporation. He may do so for the very purpose of escaping personal liability.'

"Wormser, in his 'Disregard of the Corporate Fiction', goes far in holding a parent corporation liable for the debts of its subsidiary where the latter is formed for a fraudulent purpose, but he distinctly limits the rule as follows (p. 18): 'It follows that no fraud is committed in incorporating for the precise purpose of avoiding and escaping personal responsibility. Indeed, that is why most people incorporate, and those dealing with corporations know, or at least are presumed to know, the law in this regard.' "

Gledhill v. Fisher & Co. (Mich.), 262 N.W. 371, 373.

In the New York case quoted in the foregoing it is further said:

"The fact that one man may own all but a few shares of the stock, and be in fact the dominant and controlling factor or the only active manager of the corporation, is no evidence in and of itself that the corporation does not exist as a person in

the eyes of the law actually owning, operating, and controlling property."

Elenkrieg v. Siebrecht, supra, 144 N.E. 519, 521.

In brief, the device of disregarding corporate entity is a shield for protective use only against fraud, designs unconscionable in equity and avoidance of obligations imposed by law, and not as a sword to attack lawful acts.

CONCLUSION.

It is submitted that the order of the learned District Judge setting aside and vacating the order of the referee be affirmed without the requirement of a remand to re-examine the question of disregarding the corporate entity of the bankrupt.

Dated, San Francisco,
August 27, 1948.

Respectfully submitted,
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